

Unocal Alaska

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Kevin A. Tabler, Manager
Land/Government Affairs

April 1, 2004

Mr. Tom Irwin, Commissioner
Department of Natural Resources
550 West 7th Avenue, Suite 1400
Anchorage, AK 99501

Cook Inlet Area
State of Alaska
Royalty in Kind Gas Sales
Expression of Interest Notice 3-15-04

Dear Mr. Irwin:

Union Oil Company of California (Unocal) is in receipt of your letter dated March 15, 2004, inquiring if Unocal has an interest in purchasing Cook Inlet Royalty-In-Kind (RIK) gas, or might be affected by the sale of same. The short answer is, only under the right circumstances would we be interested in purchasing gas and any RIK sale of gas will definitely impact our ongoing operations, possibly leading to higher costs, operational uncertainty and deliverability difficulties. Given the current supply situation in the Cook Inlet, Unocal opposes a sale of RIK gas. Below is a brief summary and discussion of some of the factors influencing our answer and areas of concern or caution we would like you to consider before deciding to move forward with an actual RIK gas sale proposal.

The following bulleted items reflect Unocal's position:

Summary:

- The foregoing said, Unocal is not opposed in principle to the notion of RIK gas sales however, we are very concerned about the impact such a sale or sales will have on the already fragile Cook Inlet gas market. The state has the right to take its gas in kind and Unocal does not oppose such a sale at the right time, and as long as it is a fair, transparent process where ample lead time is given to producers and current gas customers to adjust to the new delivery situation. We expect the state will resolve the issues and complications discussed herein and structure the bid process in such a way as to not increase our costs as operators or further complicate or create an unworkable delivery system in Cook Inlet.

- A RIK sale of gas will be a complex and multifaceted endeavor. In this particular case, we believe it will create an unworkable situation in Cook Inlet and therefore are opposed to such a sale at this time. Until such time as exploration creates a more secure supply of deliverable gas in Cook Inlet, RIK sales of gas will be fraught with complications and unintended consequences.
- The sale and purchase of RIK gas should be a transparent, open and public bid process. Terms and conditions should be established prior to the sale. Such terms and conditions of sale must include a fully detailed Gas Sales Agreement incorporating adequate accounting procedures and field balancing provisions which include nomination procedures and conditions in addition to firm or interruptible delivery terms. If a standard contract for royalty gas is not issued then the bids will be difficult to evaluate, subject to debate and criticism and may result in an unworkable situation for the State, buyer and producer. Careful and deliberate consideration must be given to these terms and conditions. The sale of RIK gas is more problematic and not straight forward (unlike royalty-in-kind oil sales).
- The sale should be open only to pre-qualified bidders who have the financial capability and credit worthiness to handle such a purchase and who have a legitimate market for the gas. Speculators, who have no market position, should not qualify as it may strand the state's gas and create unmanageable field deliveries.
- The state should be bound to take the high bidder. All royalty gas must be put up for sale and treated equally regardless of whether or not there are current Royalty Settlement Agreements.
- The state should give ample lead time for existing producers and customers to adjust to the sale. Royalty gas that has been committed under an existing contract should be subject to a three year lead time. Commitments have been made and significant exploration and development capital investment expended under business plans developed to utilize and deliver the state's royalty share under existing contracts.
- The state should follow through with the sale after it is offered. A RIK gas sale will not alleviate the imminent Cook Inlet gas shortage, only increased exploration and new discoveries will curtail the shortfall. A sale of RIK gas may only result in shifting the gas short fall from one consumer to another.
- Due to the profile of the deliveries that would be expected under any RIK gas sale and the constraints imposed by Unocal's current contracts, Unocal would have no incentive to bid on a RIK gas supply.

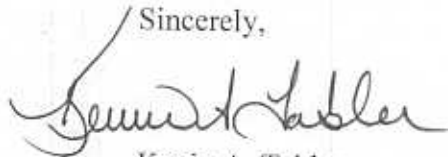
In conclusion, sales of RIK gas will be complex and not as straight forward as a Royalty-In-Kind sale of gas or oil on the North Slope. The shortage of gas, seasonal nature of deliveries, demand profiles, complicated field balancing, exchange arrangements, Royalty Settlement Agreements and fragile interplay of the gas consumers in Cook Inlet lend any RIK gas sales to a multitude of unintended consequences. Gas balancing will be a particularly problematic issue and one dependant on the source of the gas and the needs of the successful bidder. The needs of a utility market are dramatically different than the needs of an industrial customer. The current supply and demand market place is working. We have seen an increase in gas sale pricing which has stimulated the desired response of increased exploration and higher valuation for the state. Any sale of RIK gas

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under an artificial negotiated lower pricing mechanism will reduce the state's revenue share and create operational and financial hardships on those lessor's (producers) who have planned to sell RIK gas under existing contracts and are seeking the highest priced markets.

We welcome the opportunity to discuss the matter of RIK gas sales with you further should you wish. If you have any questions, please do not hesitate to contact the undersigned a (907) 263-7600.

Sincerely,

A handwritten signature in dark ink, appearing to read "Kevin A. Tabler". The signature is fluid and cursive, with a large initial "K" and "T".

Kevin A. Tabler